Virginia Information Technologies Agency
VITA
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February 2006 Finance Report

Information Technology Investment Board
Finance and Audit Committee
February, 2006

This Finance Report covers the following topics:

- Fiscal Year 2006 Financial Results
- Rates for New Services
- Memoranda of Understanding (MOU) With Agencies
- Legislative Budget Development
- PPEA Contract Financial Update

Fiscal Year 2006 Financial Results

December 2005 Financial Results
All Funds

	FY 2006 Budget	December 2005 Actual Results	Actual as a Percent of Budget
Operating Revenues, including transfers in	$295,689,670	$141,853,428	48%
Expenses, including transfers out	293,441,282	139,486,424	48%
Net Change	2,248,388	2,367,004	
Retained Earnings, July 1	51,427,204	54,110,505	
Ending Retained Earnings	$53,675,592	$56,477,509	

Overall, financial activity in all funds through the first half of fiscal year 2006 is in line with expectations. VITA continues to process a large number of transactions on behalf of transitioned agencies, with almost 40% of internal service fund (ISF) revenue derived from direct billed services.

December 2005 Financial Results
Internal Services Fund

	FY 2006 Budget	December 2005 Actual Results	Actual as a Percent of Budget
Operating Revenues, including transfers in	$248,968,827	$114,402,690	46%
Expenses, including transfers out	246,567,038	110,475,098	45%
Net Change	2,401,789	3,927,592	
Retained Earnings, July 1	29,576,780	32,260,081	
Ending Retained Earnings	$31,978,569	$36,187,673	

These funds account for the majority of VITA's revenues and expenses, including telecommunications, computer services, and direct billed services.

FY 2006 will be the first full year of experience with revenue earned from direct bill. Last year's limited experience indicated that customer agency spending for IT goods and services will peak in the last two months of the fiscal year. Consistent with this, revenues and expenses, as a percent of total budget, are slightly low in the first half of the fiscal year. Net income, on the other hand, is higher than expected.

The percentage of payments in compliance with the Prompt Payment Act through the first half of 2006 was 97.1%.

December 2005 Financial Results
Enterprise Funds

	FY 2006 Budget	December 2005 Actual Results	Actual as a Percent of Budget
Operating Revenues, including transfers in	$39,005,696	$23,470,050	60%
Expenses, including transfers out	39,005,696	25,580,150	66%
Net Change	0	(2,110,100)	
Retained Earnings, July 1	20,442,577	20,442,577	
Ending Retained Earnings	$20,442,577	$18,332,476	

VITA's Enterprise Funds are comprised of the portal access program and E-911. Revenues and expenses have been reduced by $11.7 million to remove "pass-through" funding for VITA's portal access (VIPNet) program. Virginia Interactive, under contract to VITA, collects portal access and subscription fees from the business community. Until recently, those funds were then transferred, or "passed through," to the appropriate state agencies by VITA, who acted as a transfer agent for these funds. However, effective with the 12/14/2005 signing of an amendment to the contract, Virginia Interactive will pay the funds collected directly to the appropriate state agencies; VITA will now serve only as the administrator of the contract and not as the transfer agent.

The Virginia Wireless E-911 Services Board promotes and assists in the development, deployment, and maintenance of enhanced wireless emergency telecommunications services and technologies. The E-911 fund took in almost $21 million in revenue during the first half of the year and paid out just over $22.2 million to providers.

December 2005 Financial Results
General Fund

	FY 2006 Budget	December 2005 Actual Results	Actual as a Percent of Budget
Operating Revenues, including transfers in	$2,885,187	$1,070,457	37%
Expenses, including transfers out	2,885,187	1,070,457	37%
Net Change	0	0	
Retained Earnings, July 1	0	0	
Ending Retained Earnings	$0	$0	

The general fund is used primarily to fund the activities of the Strategic Management Services directorate. The amounts shown above indicate that spending is below target. However, the budget figures do not reflect the already-executed $1.6 million appropriation transfer for savings from information technology and telecommunications operating efficiencies. Based on the executive budget (HB/SB 29), which proposes deferring this general fund reduction until FY 2007, VITA anticipates this appropriation will be "made whole" subsequent to legislative budget approval (April 2006). If this restoration does not occur, however, VITA's remaining general fund dollars will quickly be exhausted.

December 2005 Financial Results
Special Revenue Funds

	FY 2006 Budget	December 2005 Actual Results	Actual as a Percent of Budget
Operating Revenues, including transfers in	$3,880,000	$2,910,231	75%
Expenses, including transfers out	4,033,401	2,119,381	53%
Net Change	(153,401)	790,850	
Retained Earnings, July 1	1,165,722	1,165,722	
Ending Retained Earnings	$1,012,321	$1,956,572	

Special Revenue Funds are primarily comprised of funding for the IFA, PPEA, GIS, and Virginia Technology Infrastructure with December 2005 fund balances totaling $1,800,000. The only area with any notable activity was the Industrial Funding Adjustment (IFA) account. Revenues for the IFA are the result of contractual payments made by the state's information technology vendors. This account funds general government activities, including support to the Governor's Office, that should not be billed to state agencies and other customers.

December 2005 Financial Results
Federal Funds

	FY 2006 Budget	December 2005 Actual Results	Actual as a Percent of Budget
Operating Revenues, including transfers in	$950,000	$0	0%
Expenses, including transfers out	1,192,125	241,339	0%
Net Change	(242,125)	(241,339)	
Retained Earnings, July 1	242,125	242,125	
Ending Retained Earnings	$0	$786	

There has been limited activity in the Federal Funds in the first half of FY 2006, as VITA is still waiting for the first $617,500 drawdown against a $950,000 Homeland Security Grant. As soon as the drawdown is received, additional funds will be expended here for IT security activities; the agency expects to spend the entire $950,000 provided by the end of the fiscal year.

Rates for New Services

RATES APPROVAL

Following approval of an alternative methodology for project management by the ITIB at its December 8 meeting, the CIO presented a new ITIM rate proposal to the ISF Subcommittee for consideration at the December 12 JLARC meeting.

The project management rate proposal approved by the ISF Subcommittee is summarized below:

Governance

- Charge non-higher ed agencies via existing overhead rates (no rate increase needed at this time)
- Capture higher ed governance costs through flat fees for oversight
  Recovery Target for Governance = $104,486

Category*	% of Total	Total Cost
Small	5.06%	$ 5,286
Medium	16.12%	$ 16,839
Large	78.82%	$ 82,360
Total	**100.00%**	**$104,486**

* based on number of students enrolled in the institution

Oversight

- Charge customers for specific project management services used:
  - $74.74/hour for all

During its regular December 12 meeting, JLARC approved all of VITA's proposed rates as recommended by the ISF Subcommittee on December 1 and December 12.

IMPLEMENTATION PLAN FOR NEW RATES

VITA learned in December that the executive budget proposal for the 2006-2008 biennium recommends funding increases for customer agencies, including higher education institutions, which will be charged the new rates for project management and security. Recommendations are for general funds only, based on each agency's percentage of state dollars used for information technology expenses. These new appropriations, if approved, will be available to customers beginning July 1, 2006.

Accordingly, executive branch leadership has asked VITA to defer implementation of the new rates until the affected agencies (1) can access the additional general fund appropriations designated for this purpose (July 1, 2006), and (2) have adequate time to plan and adjust their nongeneral fund revenue streams (e.g. fees for services, federal grants), as needed, to assure adequate funding. VITA plans to begin charging for the project management governance costs (no rate increase required in the near term) in March 2006; continue charging for oversight activities, as requested by customers, using the new rate structure; and implement security rates at the beginning of FY 2007.

Memoranda of Understanding With Agencies

Beginning in FY 2005 when VITA absorbed IT personnel and assets from executive branch (in-scope) agencies, a direct bill methodology has been employed to recover the direct and administrative expenses associated with providing the IT goods and support services VITA assumed statewide responsibility for as a result of transition. This chargeback methodology was implemented as an interim measure to begin the transformation of the Commonwealth's IT infrastructure to a consolidated environment.

Continuing towards transformation and in support of the recent decision to enter into a partnership with Northrop Grumman, VITA is taking another step towards consolidation and sharing of resources. The first phase involves reorganizing the personnel resources currently providing IT support to in-scope customer agencies into a regional model that facilitates the sharing of resources, allows for cross training, and provides greater efficiency in the delivery of services. In order to support this organizational model, VITA is revising its chargeback methodology for personnel resources from direct billing for named persons to a flat monthly fee for services provided.

VITA has developed Memoranda of Understanding (MOU) for each customer agency and is actively engaged with customers to achieve understanding of and agreement on the services VITA will deliver and the fees that will be charged. To date, approximately 34 of the 63 in-scope customer agencies have signed the MOU. The target date for full implementation of phase 1 is March 2006.

On the heels of securing agreements on labor-related services and costs, VITA is beginning work on phase 2 of the MOU project. This will address customer agency spending for IT goods and external (non-VITA) services such as servers, desktops, network devices, software, maintenance renewals and seat management contracts. Centralizing the purchasing of IT goods, products, and services is a necessary step towards transformation and consolidation. It also supports the contractual agreement with Northrop Grumman currently set to commence on July 1.

Taking this next step in the transformation process will further facilitate the consolidation and sharing of resources (both personnel and non-personnel) while allowing customers to focus on their need for services that support their businesses rather than purchasing component parts to build and maintain the IT infrastructure. With phase 2, VITA intends to build on the MOU chargeback methodology of phase 1 by adding fixed monthly fees to cover the cost of IT infrastructure goods and services. VITA also plans to develop service rates for incremental growth within the current customer base as well as for new customers requesting VITA services.

Legislative Budget Development

On December 16, 2005, Governor Warner presented his 2006-2008 biennial budget (HB/SB 30), as well as FY 2006 amendments (HB/SB 29) to the current Appropriation Act (Chapter 951), to the House of Delegates' Appropriations and Finance Committees and the Senate Finance Committee. Actions in the Governor's budget proposal that are specific to VITA include:

HB/SB 29 – amends FY 2006 budget

- Language cites Governor's approval of interim agreement with Northrop Grumman; capital lease approval provisions and reporting requirements
- Defer $5M savings initiative directed at VITA and customers to FY 2007 ($1.6M GF)
- Fund agencies' general fund share of increases in cost of living adjustments for IT employees transitioned to VITA

HB/SB 30 – establishes FY 2007, 2008 budgets

- Increase revenue in Wireless E-911 fund ($7.5M FY 2007; $8.5M FY 2008); add 3 FTEs each year for regional support
- Restore Wireless E-911, VIPNet funding transferred to general fund ($.9M FY 2007, $1.9M FY 2008)
- Partially fund completion of VGIN's base map update ($2M FY 2007; $.5M FY 2008—both GF)
- Increase revenue for VBMP, address file operations ($.3M each year); add 3 FTEs each year to support
- Retain savings reductions initiative in biennium, add deferred savings reduction from FY 2006 to FY 2007 (-$1.6M GF FY 2007)
- Fund agencies' general share of increases in (1) cost of living adjustments for IT employees transitioned to VITA; (2) shared services rate impact; (3) increased rates for project management and security (both years)
- Appropriate existing funding for IFA support of central government activities ($2.9M FY 2007; $3.1M FY 2008)
- Language amendments:
  - Eliminate redundant E-911 language
  - Establish line of credit ($5M)
  - Expand scope of local contracts
  - Require Governor's approval of VITA's rate proposals prior to submission to JLARC
  - Establish a VITA Advisory Committee
  - Adjust VITA position level for employees transferring to NG

The first milestone in the legislature's active engagement in the budget development process is the submission, by members of the House of Delegate and the Senate, of amendments to the Governor's budget proposal. The Governor concurrently offers executive amendments to the budget. Amendments submitted by General Assembly members that are specific to VITA include:

HB/SB 30 – establishes FY 2007, 2008 budgets

- Fully fund completion of VGIN's base map update—Senator Watkins, Delegate Sherwood ($.7M GF FY 2007)
- Fund quality assurance of base map product—Senator Watkins, Delegate Sherwood ($.5M GF FY 2007)
- Restore VIPNet funding transferred to general fund—Delegate Nixon ($.5M FY 2007)

On February 19, the House Appropriations and Senate Finance Committees will present their respective budget amendment recommendations. At this juncture, VITA will learn (1) the outcome of the member amendments for the base map update and (2) if other issues of interest to this agency are surfaced. The definitive written reports on the money committee amendments follow on February 21. Information on the money committee reports' impact on VITA will be provided to FAC members shortly thereafter.

PPEA Contract Financial Update

Throughout December and January, VITA Finance and Service Management Organization (SMO) staff members have been working closely with the Department of Accounts (DOA) to develop a worst-case scenario depicting the anticipated debt obligations to the Commonwealth of potential capital leases inherent in VITA's comprehensive agreement with Northrop Grumman. The methodologies and projections used in the worst-case scenario, quantified in the table below, have been validated by the State Comptroller and the Auditor of Public Accounts (APA). This information is also being used by the CIO in his various presentations to legislators on the PPEA service agreement and its funding implications.

BEGINNING LEASE OBLIGATION BALANCES (Worst Case)

PPEA Infrastructure Tower	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
Security	$1,799,376	$1,457,247	$1,111,569	$1,014,228	$862,960	$405,879	$305,125	$476,720	$593,846	$434,529
Messaging	$3,462,462	$2,769,970	$2,077,477	$1,469,384	$760,012	$50,639	$33,760	$101,279	$67,519	$50,639
Mainframe	$9,381,133	$9,178,317	$9,297,213	$11,151,812	$11,089,316	$13,912,762	$12,620,337	$26,314,198	$23,215,049	$21,924,313
Server	$12,074,577	$9,800,756	$12,960,834	$12,624,924	$11,563,484	$7,696,719	$6,539,357	$7,836,181	$8,298,537	$8,874,419
Data Network	$17,610,256	$62,149,002	$91,431,651	$76,690,905	$61,950,159	$47,209,412	$32,468,666	$24,308,375	$17,723,769	$16,828,739
Voice Network	$0	$0	$0	$15,081,452	$21,710,413	$18,301,140	$14,891,868	$11,482,596	$8,073,324	$4,664,051
Desktops and Network Printers	$14,484,425	$49,937,265	$66,083,483	$51,077,682	$37,243,390	$37,673,439	$49,516,233	$46,050,658	$33,351,351	$28,417,070
Data Center Facility	$0	$32,866,320	$31,770,776	$28,484,144	$25,197,512	$21,910,880	$18,624,248	$15,337,616	$12,050,984	$8,764,352
TOTAL OBLIGATION BALANCES	**$58,812,230**	**$168,158,877**	**$214,733,003**	**$197,594,531**	**$170,377,245**	**$147,160,872**	**$134,999,594**	**$131,907,623**	**$103,374,379**	**$89,958,112**
Total General Fund Obligation (47%)	**$27,641,748**	**$79,034,672**	**$100,924,511**	**$92,869,429**	**$80,077,305**	**$69,165,610**	**$63,449,809**	**$61,996,583**	**$48,585,958**	**$42,280,313**

Key points:

- Under the worst case scenario (that is, every tower found to be a capital lease) $101 million is the largest one-year (FY 2009) capital lease obligation
- Presently, only the Desktop tower is determined to include capital leases, its maximum one year obligation is $31M
- For purpose of comparison, current VITA's annual budget for infrastructure services is $240 million

Any aspects of the comprehensive agreement with Northrop Grumman that constitute a capital lease will add to the state debt. Increases in the state debt affect the Commonwealth's revenue capacity and flexibility as well as its bond rating. Under the proposed PPEA approval language in HB/SB 29, VITA is responsible for identifying the lease costs, by year of the contract, to the Treasury Board.

Determination of whether there are implied capital leases in the Northrop Grumman agreement will continue. VITA has assured executive and legislative branch decision makers of its commitment to following this issue closely and reevaluating all potential capital leases when (1) the comprehensive agreement receives final approval by virtue of General Assembly and gubernatorial action and (2) further details of the nature of Northrop Grumman's acquisition of assets emerge in the following months.